

Report  
of the  
Examination of  
Middleton Insurance Company  
Middleton, Wisconsin  
As of December 31, 2001

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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July 26, 2002

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Honorable Connie L. O'Connell  
Commissioner of Insurance  
State of Wisconsin  
121 East Wilson Street  
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2001, of the affairs and financial condition of

MIDDLETON INSURANCE COMPANY  
Middleton, Wisconsin

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The last examination of this company was made in 1994 as of December 31, 1993. The current examination covered the intervening time period ending December 31, 2001, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on January 4, 1876, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Middleton Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used. Effective January 1, 1993, Cottage Grove-Oregon Mutual Insurance Company merged into the company.

During the period under examination, there was one amendment to the articles of incorporation and no amendments to the bylaws. The amendment to the articles of incorporation set an age limit for policyholders to be eligible for election to the board of directors. The change states that the person seeking to obtain a director position must not have attained the age of 75 years in the year of election.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following ten counties:

Columbia, Dane, Dodge, Grant, Green, Iowa, Jefferson, LaFayette, Rock, and Sauk

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year with premiums payable on the advance premium basis. Installment payments are allowed on policies if the installment premium is over \$100. Installment fees are charged policyholders. Any policy fees charged policyholders are retained by the company.

Business of the company is acquired through 112 agents in 39 agencies, 3 of whom are directors of the company. Agents are presently compensated for their services as follows:

<b>Type of Policy</b>	<b>Compensation</b>
All Lines of Business Written by the Company	15%

Agents are not authorized to adjust losses. Losses are adjusted by a professional adjuster or by the home office. The company's reinsurer adjusts all liability losses.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

#### **Board of Directors**

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term. The current board of directors consists of the following policyholders of the company:

<b>Name</b>	<b>Principal Occupation</b>	<b>Residence</b>	<b>Expiry</b>
Richard Doerfer	Farmer	Verona	2003
Tim Klongland	Real Estate	Stoughton	2003
Roger Symdon	Retired/Co-CEO of Middleton Insurance Company	Oregon	2003
Lyman Anderson	Retired	Oregon	2004
*Carl Chandler	Agent	Blanchardville	2004
Gerald Jensen	Farmer	Oregon	2004
Philip Peterson	Retired	Oregon	2002
*, **Eric Warmuth	Agent	Belleville	2002
*Joseph Esch	Agent	Dodgeville	2002

\* Directors who are also agents are identified with an asterisk.

\*\* Eric Warmuth resigned as a director in May of 2002. The board of directors at the April 22, 2002 board meeting approved the resignation.

Members of the board currently receive \$75 for each board meeting attended, \$35 for each committee meeting attended and \$0.345 per mile for travel reimbursement.

### **Officers**

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. The chief executive officers are appointed by the board of directors and do not need to be directors of the company.

Officers and CEOs serving at the present time are as follows:

<b>Name</b>	<b>Office</b>	<b>Current Salary</b>
Philip Peterson	President	\$ 1,000
*Roger Symdon	Vice President/Co-CEO	Paid an Hourly Wage
*Steve Leadholm	Co-CEO	Paid an Hourly Wage
Richard Doerfer	Secretary/Treasurer	1,200

\* The current Co-CEO's are not paid an annual salary like their predecessor who was paid \$53,000 per year. Roger Symdon is compensated at \$75.00 per day and is reimbursed for mileage to and from the home office. It should be noted that Roger works part time and averages about three hours of work time per day. Steve Leadholm is compensated as an outside contractor. His duties consist of valuing property for new or renewed business. He is compensated for those services at a rate of \$30.00 per hour, \$0.365 per mile, and a \$1.00 per picture. Both the rate for inspection time and mileage is prorated if there are more than one inspection completed in any given trip. He also performs the company's claims adjusting function. He receives \$45.00 per hour for adjusting, which is prorated if there are a number of smaller claims in the same general area. He is also compensated a \$1.00 per photo, and

\$0.365 per mile (pro rated if there are more than one claim that he is adjusting in the same general area).

Steve charges the company for in-office claims adjusting consulting at \$35.00 per an hour.

### **Committees of the Board**

The company's bylaws allow for the formation of certain committees by the board of directors.

The committees at the time of the examination are listed below:

#### **Loss Adjustment Committee**

Richard Doerfer, Chair  
Lyman Anderson  
Tim Klongland

#### **Finance Committee**

Roger Symdon, Chair  
Carl Chandler  
Eric Warmuth

#### **Budget and Salary Committee**

Joseph Esch, Chair  
Gerald Jensen

#### **Executive Committee**

Philip Peterson, Chair  
Roger Symdon  
Richard Doerfer

### **Growth of Company**

The growth of the company during the past eight years as compiled from its filed annual statements was as follows:

<b>Year</b>	<b>Net Premiums Earned</b>	<b>Net Losses and LAE Incurred</b>	<b>Policies In Force</b>	<b>Net Income</b>	<b>Admitted Assets</b>	<b>Policyholders' Surplus</b>
1994	\$594,958	\$400,757	2,795	(\$48,372)	\$1,093,217	\$553,157
1995	621,884	465,658	2,883	(91,487)	1,154,957	504,266
1996	711,033	422,017	2,792	38,503	1,382,799	644,888
1997	722,969	567,218	2,743	(11,490)	1,242,740	528,215
1998	649,366	515,042	2,652	(131,020)	1,111,658	511,273
1999	873,996	520,534	2,577	8,798	1,270,640	515,551
2000	865,601	767,732	2,483	(256,248)	1,136,489	351,708
2001	847,401	664,000	2,243	(89,307)	897,476	232,632

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past eight years were as follows:

<b>Year</b>	<b>Gross Premiums Written</b>	<b>Net Premiums Written</b>	<b>Ending Surplus</b>	<b>Writings Ratios Gross</b>	<b>Net</b>
1994	\$1,231,652	\$ 595,417	\$553,157	223%	108%
1995	1,301,306	687,476	504,266	258	136
1996	1,381,530	720,316	644,888	214	112
1997	1,289,507	717,518	528,215	244	136
1998	1,239,496	608,081	511,273	242	119
1999	1,262,597	1,002,135	515,551	245	194
2000	1,241,861	860,288	351,708	353	245
2001	1,130,401	797,279	232,632	486	343

For the same period, the company's operating ratios were as follows:

<b>Year</b>	<b>Net Losses and LAE Incurred</b>	<b>Other Underwriting Expenses Incurred</b>	<b>Net Earned Premiums</b>	<b>Loss Ratio</b>	<b>Expense Ratio</b>	<b>Composite Ratio</b>
1994	\$400,757	\$267,569	\$594,958	67%	45%	112%
1995	465,658	288,795	621,884	75	46	121
1996	422,017	284,647	711,033	59	40	99
1997	567,218	294,895	722,969	78	41	119
1998	515,042	288,405	649,366	79	44	123
1999	520,534	364,853	873,996	60	42	102
2000	767,732	374,395	865,601	89	43	132
2001	664,000	339,757	847,401	78	40	118

The company has reported composite ratios of over 115% in four out of the past five years and the company's composite ratio has been significantly higher than the industry average in four of the last eight years. The company also reported underwriting losses in seven of the past eight years resulting in total underwriting losses of \$939,066. The Incurred Loss and LAE ratio has averaged 73% over the period covered under this examination. There have been net losses reported six times over this same period, the largest one occurring in 2000 of \$256,248. Gross Premiums Written decreased slightly over the eight year-period from 1994 to 2001, while Net Premiums Written increased by 34% due to a change in the company's reinsurance program in which the company elected to retain more premium and more underwriting risk. The policyholders' surplus balance has decreased by about 58% in the last eight years and was close to minimum regulatory requirement of \$200,000 at year-end 2001.

The continued increase in the ratio of premiums written to surplus is a result of the deteriorating surplus with minimal reduction in premium volume. The ratio of premiums written to surplus increased from 108% in 1994 to 343% in 2001. The company needs to significantly reduce its premium volume proportional to the reduction in surplus. The company uses 39 agencies and 112 agents, which is far too many in light of its poor underwriting results and its need to reduce premium volume.

One positive comment is that the company's home office building, located on a busy street in suburban Madison, was reported at \$16,601 at year-end 2001, but its market value substantially higher. In July, 2002, the company sold its home office building for \$240,000 and entered into a six-year lease agreement (with an early termination option clause) to continue to use the property. The lease agreement stipulates that the company pay the lessor \$22,500 per annum for rent with an annual increase of 2% per year. The company also has to assume the lessor's real estate taxes, special assessments and building and fire insurance expenses. The company's reported surplus increased significantly as a result of the sale.

## II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty with five classes. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective Date:	January 1, 2002
Termination provisions:	Any January 1 by either party giving at least 90 days' advance notice in writing

The coverage provided under this treaty is summarized as follows:

- |                      |   |
|----------------------|---|
| Type of contract:    | Excess of Loss (Class A)  |
| Lines reinsured:     | Liability (nonproperty)   |
| Company's retention: | \$5,000 for each and every loss occurrence up to policy limits.   |
| Coverage:            | 100% in excess of retention including loss adjusting expense. Subject to policy limits of \$1,000,000 for bodily injury and property damage, and \$5,000 per person and \$25,000 per accident for medical payments. |
| Reinsurance premium: | 50% of gross liability premiums charged for each policy issued, which equals the liability reinsurance rates.   |
- |                      |   |
|----------------------|---|
| Type of contract:    | First Surplus (Class B)   |
| Lines reinsured:     | All property business   |
| Company's retention: | \$250,000 plus at least 50% of each risk ceded pro rata. The company also has a 10% aggregate deductible on this layer of coverage. |
| Coverage:            | Pro rata portion of each loss and LAE up to \$800,000 above retention.  |
| Reinsurance premium: | Pro rata portion of premium and fees on each risk ceded.  |
| Ceding commission:   | Provisional commission of 15%, with minimum of 15% and maximum of 35% based on the loss ratio.                                      |



3. Type of contract: Excess of Loss (Class C-1)  
Lines reinsured: All property business written  
Company's retention: \$50,000 for each and every risk from one loss occurrence.  
Coverage: \$100,000 each and every risk and loss occurrence, including loss adjusting expense, above retention.  
Reinsurance premium: Rate based on net premium written and losses incurred for immediate preceding four years. Minimum rate of 5% and maximum rate of 24% of current net premium written. The 2002 annual rate is 7.44%. Deposit premium of \$56,400.  
Termination premium: If contract is canceled, final rate based on net premium written and losses incurred for immediate preceding four years plus current years net premium written and losses incurred.  
Other: Contract applies only to portion of business company retains net for its own account.
4. Type of contract: Second Excess of Loss (Class C-2)  
Lines reinsured: All property business written  
Company's retention: \$150,000 each and every risk from one loss occurrence.  
Coverage: \$100,000 each and every risk and loss occurrence, including loss adjusting expense, above retention.  
Reinsurance premium: 1% of net premiums written for business covered subject to minimum premium of \$6,000 and deposit premium of \$7,500.
5. Type of contract: Stop Loss (Class D/E)  
Lines reinsured: All business written  
Company's retention: Losses in aggregate equal to 65% of the net premiums written and a minimum amount of retention of \$445,000 in the aggregate for the year.  
Coverage: 100% of aggregate losses, including loss adjustment expenses, in annual period that exceed the retention.  
Reinsurance premium: Rate of losses incurred divided by net premiums written for last eight years losses incurred times 125%, applied to net premiums written with a minimum rate of 6% and maximum of 25%. The 2002 annual rate is 7.08%. Deposit premium of \$60,000.

### **III. FINANCIAL DATA**

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2001. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

**Middleton Insurance Company**  
**Statement of Assets and Liabilities**  
**As of December 31, 2001**

<b>Assets</b>	<b>Ledger</b>	<b>Nonledger</b>	<b>Not Admitted</b>	<b>Net Admitted</b>
Cash in Company's Office	\$ 100	\$	\$	\$ 100
Cash Deposited in Checking Account	3,708			3,708
Cash Deposited at Interest	190,354			190,354
Stocks or Mutual Fund Investments (at Market)	466,680			466,680
Real Estate (Net of Accumulated Depreciation and Encumbrances)	16,601			16,601
Premiums and Agents' Balances In Course of Collection	78,385			78,385
Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due	103,457			103,457
Investment Income Due or Accrued		3,085		3,085
Reinsurance Recoverable on Paid Losses and LAE	20,813			20,813
Electronic Data Processing Equipment – Excluding Software (Cost Less Accumulated Depreciation)	<u>14,293</u>	<u>          </u>	<u>          </u>	<u>14,293</u>
<b>TOTALS</b>	<b><u>\$894,391</u></b>	<b><u>\$3,085</u></b>	<b><u>\$          </u></b>	<b><u>\$897,476</u></b>

**Liabilities and Surplus**

Net Unpaid Losses	\$ 47,080
Unpaid Loss Adjustment Expenses	1,630
Commissions Payable	27,158
Fire Department Dues Payable	9,221
Borrowed Money Unpaid	50,000
Unearned Premiums	475,981
Reinsurance Payable	23,676
Amounts Withheld for the Account of Others	1,357
Other Liabilities:	
Expense Related	
Accounts Payable	3,500
Accrued Property Taxes	4,800
Nonexpense Related	
Premiums Paid in Advance	<u>20,441</u>
TOTAL LIABILITIES	664,844
Policyholders' Surplus	<u>232,632</u>
TOTAL	<u>\$897,476</u>

**Middleton Insurance Company**  
**Statement of Operations**  
**For the Year 2001**

Net Premiums and Assessments Earned	<u>\$ 847,401</u>
Deduct:	
Net Losses Incurred	590,088
Net Loss Adjustment Expenses Incurred	73,912
Other Underwriting Expenses Incurred	<u>339,757</u>
Total Losses and Expenses Incurred	<u>1,003,757</u>
Net Underwriting Gain (Loss)	<u>(156,356)</u>
Net Investment Income:	
Net Investment Income Earned	<u>9,706</u>
Total Investment Income	<u>9,706</u>
Other Income:	
Miscellaneous Income	7,943
Policy Fee Income	<u>49,400</u>
Total Other Income	<u>57,343</u>
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes	<u>(89,307)</u>
Net Income (Loss)	<u>(\$ 89,307)</u>

**Middleton Insurance Company**  
**Reconciliation and Analysis of Surplus as Regards Policyholders**  
**For the Eight-Year Period Ending December 31, 2001**

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
Surplus, beginning of year	\$630,702	\$553,157	\$504,266	\$644,888	\$528,215
Net income	(48,372)	(91,487)	38,503	(11,490)	(131,019)
Net unrealized capital gains or (losses)	(34,775)	40,412	104,084	(106,758)	109,357
Change in non-admitted assets	5,602	2,184	(1,965)	1,575	4,721
Surplus, end of year	<u>\$553,157</u>	<u>\$504,266</u>	<u>\$644,888</u>	<u>\$528,215</u>	<u>\$511,274</u>

	<b>1999</b>	<b>2000</b>	<b>2001</b>
Surplus, beginning of year	\$511,274	\$515,551	\$351,708
Net income	8,798	(256,248)	(89,307)
Net unrealized capital gains or (losses)	(3,271)	91,320	(29,934)
Change in non-admitted assets	(1,250)	1,085	165
Surplus, end of year	<u>\$515,551</u>	<u>\$351,708</u>	<u>\$232,632</u>

## Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2001, Annual Statement	\$232,632
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Item	Increase	Decrease	
Unpaid LAE		\$ 4,845	
Accounts Payable	<u>          </u>	<u>3,328</u>	
 Total	 <u>\$          </u>	 <u>\$ 8,173</u>	
 Decrease to Surplus per Examination			<u>8,173</u>
 Policyholders' Surplus per Examination			<u><u>\$224,459</u></u>

Reclassification Account	Debit	Credit	
Premiums Paid in Advance	\$20,441		
Premiums and Agents Balances In the Course of Collection	<u>          </u>	<u>\$20,441</u>	
 Total	 <u>\$20,441</u>	 <u>\$20,441</u>	

#### IV. SUMMARY OF EXAMINATION RESULTS

##### Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that there be minutes for all committees of the board of directors and that the board minutes indicate approval of investment transactions.

Action—Noncompliance, see comments in the summary of current examination results.

2. Corporate Records—It is recommended the company comply with s. 628.05(2), Wis. Stat., which requires that only an agent licensed for liability (nonproperty) insurance and listed for the company solicit and sign the application for policies with nonproperty coverages.

Action—Compliance

3. Underwriting—It is recommended that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and of renewal business is inspected independent of the risk under consideration.

Action—Compliance.

4. Middleton Insurance Agency—Since that agency is not legally empowered to do business, it is recommended that the Middleton Insurance Agency stop writing business until it is duly incorporated. It is also recommended that the town mutual not pay any expenses on behalf of the agency, until the town mutual has entered into a written agreement with the agency for the allocation and reimbursement of shared expenses and such agreement has been approved by OCI.

Action—Compliance

5. Operating Results—It is recommended that the company file a business plan with the Commissioner that implements changes to improve its financial results, after a review of underwriting, rates, loss control, inspections, commissions, and the reinsurance program.

Action—Compliance

6. Reinsurance—It is again recommended that the company accurately answer annual statement interrogatory number five regarding maximum possible fire loss.

Action—Compliance

7. Reinsurance—It is recommended that first surplus ceding slips and facultative reinsurance applications be prepared and sent to the reinsurer on timely basis.

Action—Compliance

8. Policy Forms and Undertakings—It is recommended that the company refrain from writing any new commercial risks or renewing any existing commercial risks unless a signed undertaking is obtained and that the current file for all policies contain a signed undertaking, to comply with s. Ins 13.04(3), Wis. Adm. Code.

Action—Compliance



9. Policy Forms and Undertakings—It is recommended that the company use application forms approved by the Commissioner as required by s. 612.51(1), Wis. Stat.

Action—Compliance

10. Accounts and Records—It is recommended that the company comply with s. Ins 13.05(3)(a), Wis. Adm. Code, by including in its records the amount of risk reinsured and reinsurance premium by policy.

Action—Compliance

11. Accounts and Records—It is recommended that the company maintain and have available year-end reports which cross-reference and reconcile to the annual statement.

Action—Compliance

12. Cash and Invested Cash—It is recommended that the company report balances for cash deposited in checking and cash deposited at interest in the proper schedules and on the proper annual statement lines in accordance with annual statement instructions.

Action—Compliance

13. Agents' Balances or Uncollected Premiums—It is recommended in accordance with annual statement instructions that policies with an effective date after December 31<sup>st</sup> not be included on the balance sheet.

Action—Partial Compliance, see comments in the summary of current examination results.

14. Agents' Balances or Uncollected Premiums—It is recommended that the direct bill accounts receivable: be reviewed on a monthly basis, to clear amounts over 90 days past due; have timely settled balances; credit balances not be included in the receivable' and advance installment premiums be established in accordance with annual statement instructions.

Action—Compliance

15. Notes Receivable—It is recommended that the company properly report all notes receivable in Schedule G of the annual statement, and reflect such amounts under the caption "Notes Receivable" in the analysis of assets page.

Action—Compliance

16. Electronic Data Processing Equipment—It is again recommended that the company nonadmit computer furniture in future annual statements.

Action—Compliance

17. Net Unpaid Losses—It is recommended that the company comply with s. Ins 13.05, Wis. Adm. Code, by: 1) including liability claims in a loss register; 2) recording all losses in claim number order according to date reported; 3) dating all proofs of loss when signed; and 4) documenting in the claim files the review and approval of claims by the loss adjusting committee.

Action—Compliance

18. Unpaid Loss Adjustment Expenses—It is recommended that the company maintain records and reports for loss adjustment expenses which are complete and accurate, and that the company review its method for establishing its liability for unpaid loss adjustment expenses.

Action—Partial Compliance, see comments in the summary of current examination results.

19. Unearned Premiums—It is recommended that the company maintain year-end unearned premium runs by individual policy.

Action—Compliance

## **Current Examination Results**

### **Corporate Records**

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period. The following items were noted:

1. There were no minutes for meetings of the company's board appointed committees, which includes the executive committee, the finance committee and the budget and salary committee.
2. There was no approval of investment transactions including the renewal and purchase of certificates of deposit.
3. The person(s) who maintains the board of directors meeting minutes does not sign them. Signing off by the person(s) responsible for maintaining the minutes ensures that the information contained in the minutes is complete and reliable.
4. The company did not maintain a copy of documents and reports that were distributed and discussed at board meetings with the typed copy of the board minutes. Consequently, the minutes (without attachments) provide an incomplete record of the meeting and the basis for the directors' decisions.

The first two items noted above were included as a recommendation in the prior examination report. It is again recommended that minutes be maintained for all committees of the board of directors and that the board minutes indicate approval of investment transactions in accordance with s.181.1601, Wis. Stats. It is also recommended that the person(s) who maintains the board minutes and board appointed committee minutes also sign the copy of the typed meeting minutes. It is further recommended that the company maintain all reports and documents discussed at the meeting with the company's board minutes and board appointed committee minutes, in accordance with s. 181.1601, Wis. Stats.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

### **Management and Control**

Examiners reviewed board minutes to determine what actions had been taken to address the company's pattern of underwriting losses and net losses. The review of the board minutes noted the following:

1. The Executive Committee reviewed the prior CEO's performance for the two of the three years he was in charge. The board approved raises for the CEO for 1999 and 2000. In 2001, the board reached a merger agreement with the board of another town mutual insurer; the merger plan included the company's CEO to be the CEO of the merged entity. (At the joint membership meeting in March 2001, Middleton's members voted by

more than 2/3 for the merger but the other company's members did not pass the merger by the required 2/3 vote, so the merger failed. The CEO resigned from Middleton to take a position with the other town mutual insurer.)

1. The board approved the following items at the December 20, 1999 board meeting: a) all rates charged for coverage (policies) are the responsibility of the CEO; b) all underwriting is the responsibility of the CEO; c) all terminations for any reason are the responsibility of the CEO; and d) there will be reports on the above items at their regular board meetings. However, examiners found there were no reports on these items on a regular basis pursuant to the board's resolution. The company could not provide review of the CEO's performance on the items discussed above, in response to examiner inquiries.
2. The examiners noted on several occasions that the company would table a discussion and not return to it in subsequent meetings, although prior board minutes are approved at the following meeting. Items tabled included reviewing loss ratios by line of business, increasing deductibles, and review of why operating expenses have varied over a certain period of time.
3. The CEO and board members made suggestions to increase rates on homeowner policies and across all lines of business written by the company, however either the board voted it down or the item was not voted on.
4. It appeared that the board received reports from the CEO, CPA, reinsurer, etc., that provided information on various items, and the board discussed the reports and made decisions, however since the company has failed to keep copies of the reports with the board minutes it is difficult to determine the quality of the reports, and the quality of the board's decision-making.
5. On a number of occasions the company's consulting accountant, outside auditors, and reinsurer gave the company suggestions to improve the company's financial condition.. The suggestions included increasing rates, decreasing the agency force, improve underwriting, and decreasing the business written by the company. However, no action was taken on these suggestions, except for adding a \$25 policy fee effective April 1, 2002 and increasing homeowners insurance by 15% effective January 1, 2002.

The company's poor financial condition noted in the section labeled "operating results" reflects inadequate supervision of the CEO by the board, and the board's lack of action on proposals to increase rates, decrease the number of agents, improve underwriting and decrease the company's premium volume. In 2002, management appears to be implementing changes intended to correct immediate problems the company is facing, however they should have been implemented sooner.

The examiners requested written job descriptions of the co-CEO positions and signed employment agreements, which describes the role, job description, and duties of the co-CEOs of the company. The prior CEO signed an employment agreement. Since the former CEO resigned in March 2001, the company has employed two interim co-CEOs, but it is unclear what duties are assigned to whom and which one actually manages and makes decisions on behalf of the company. Neither of the interim CEOs signed an employment agreement. It is recommended that the company establish a complete detailed job description for each co-CEO position.

## **Conflict of Interest**

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. However, the procedure was not being completed on an annual basis. It was noted that the company's directors did not complete conflict of interest statements for the years 2000 and 2001. The 2002 conflict of interest forms were not filled out until they were reminded to do so during the current examination fieldwork. Therefore it is recommended that the company have its directors complete conflict of interest questionnaires on an annual basis.

The conflict of interest questionnaires were reviewed for adequate language that would disclose any conflicts of interests a board member may have. The review noted that the conflict of interest forms did not include questions that asked whether the director worked as an insurance agent for the company, and whether the director wrote business for a directly competing insurance company. It is recommended that the company amend its conflict of interest questionnaires to include language that addresses the question whether the director works as an agent for the company, and whether the director writes business for a directly competing insurance company.

## **Operating Results**

The company's public accountant issued a "going concern" opinion on the company's December 31, 2001, audit report. The notes to the audit report stated that the company's cash on hand was less than its negative cash flow in the preceding year. The company's current business plan dated July 2, 2002 was reviewed to see if the company had addressed any of the issues affecting the company as a going concern and implemented any corrective measures to turn the company's financial position around. The business plan seemed adequate, but did not address the long term goals, projections and strategies of the company. It was noted that the company has a long range planning report that covered the period from 1995 through 2000. However the company has not updated it. It is recommended that the company file an updated long range planning report with the Office of the Commissioner of Insurance that addresses long and short term goals, financial projections, strategies, rate projections, loss control, inspections, and changes the company plans to implement.

The company's leverage ratio of Direct Premiums to Surplus was 486% for 2001 (\$1,130,401/\$232,632). Had the gain on the sale of the home office building in 2002 (\$206,000) been included in 2001 reported surplus, the leverage ratio would have been 258%. This ratio indicates the amount of net worth backing the company's acceptance of underwriting risk, with a lower ratio showing more net worth backing each dollar of premium written. For town mutual insurers as a group, the leverage ratio for 2001 was 63%. The company's leverage (including the profit on the sale of the building) was over 4 times the industry average. The company's high ratio is a further concern because its net worth (including the sale of the building in 2002) is approximately represented by its investment in the common stock of its reinsurer, which is not a liquid investment.

### **Fidelity Bond and Other Insurance**

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

#### **Type of Coverage and Coverage Limits**

- 1) Capitol Indemnity Corporation (4/20/02 to Continuous)
  - a) Fidelity Bond (Blanket Employee Dishonesty)
    - i) Insured – Middleton Insurance Company
    - ii) Single loss limit: \$100,000
    - iii) No deductible
- 2) General Casualty Company of Wisconsin (6/25/02 to 6/25/03)
  - a) Property Coverage
    - i) Commercial Building: \$358,000
    - ii) Business Personal Property: \$35,000
    - iii) Minicomputer Coverage: \$25,000
    - iv) Water Back up of Sewers or Drains: \$5,000
    - v) Valuable Papers and Records: \$20,000
    - vi) \$250 deductible
- 3) General Casualty Company of Wisconsin (6/25/02 to 6/25/03)
  - a) Commercial Umbrella Liability Coverage
    - i) General Aggregate Limit: \$2,000,000
    - ii) Products-Completed Operations Aggregate Limit: \$1,000,000
    - iii) Each Occurrence Limit: \$1,000,000
    - iv) Personal & Advertising Injury Limit: \$1,000,000
    - v) Fire Damage Limit: \$100,000
    - vi) Medical Expense Limit: \$5,000
- 4) General Casualty Company of Wisconsin (2/1/02 to 2/1/03)
  - a) Workers Compensation and Employers Liability
    - i) Meets statutory requirements

- 5) Errors & Omissions Coverage for agents of Middleton Insurance Company (excluding directors that write business)
- 6) NAMIC Insurance Company Inc. (2/22/02 to 2/22/03)
  - a) Professional Liability
    - i) \$1,000,000 limit per claim
    - ii) \$1,000,000 aggregate limit
    - iii) \$5,000 deductible
  - b) Directors and Officers Liability
    - i) \$1,000,000 limit per claim
    - ii) \$1,000,000 aggregate limit
    - iii) \$5,000 deductible
  - c) Maximum aggregate limit for all coverage
    - i) \$1,000,000 per policy period

Conclusion: Insurance coverage is adequate and the fidelity bond is above the minimum requirement set by this office.

### **Underwriting**

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. The agents initially fill out new applications. The application is then reviewed by Steve Leadholm (Co-CEO), who visits the property site to inspect buildings, equipment, etc. Mr. Leadholm will make adjustments accordingly and send the final premium and policy to the agent for the proposed policyholders signature. Mr. Leadholm relies on his extensive knowledge and background when inspecting property, however, a formal inspection sheet for property was not being used as part of the inspection process. During the examination the examiners received a copy of a newly drafted inspection sheet. The inspection sheet needed revision and was not ready to be implemented prior to the completion of the current examination's fieldwork. The company finalized and implemented a formal inspection sheet during the month of November 2002.

The examiner also reviewed how many inspections that are being completed by Steve Leadholm on a monthly and annual basis. It was noted that the Mr. Leadholm was completing 20 to 30 inspections per month or about 360 inspections per year. At year-end 2001 the company reported 2,243 policies that were in force. At the current pace Steve is inspecting properties it would take him a little over 6 years to inspect the entire block of business. This is concern due to the company's past underwriting history (insuring poor risks) and current financial condition. The company needs to inspect

properties at a increased pace so that poor insurance risks can be found and either properly nonrenewed or the policyholder can make needed improvements, to help the company to achieve better underwriting results. The current inspection timeline may not be adequate to filter out the poor insurance risks before they adversely effect the company. It is recommended that the company devote more resources towards inspections to inspect all their policies within two years.

Further review of the company's inspection procedures noted that the company does not include photographs of all new and renewed business risks in its policy files. This issue with discussed with Steve Leadholm (Co-Manager) who told examiners that pictures were not being included in policy files prior to his employment. Examiners sampled 18 underwriting files, and 67% of the sample did not have photographs in them. Many of the photographs reviewed were not adequate. Currently agents are not expected to take pictures of insured risks, however Steve Leadholm takes pictures when he inspects properties and adjusts claims. It may take a while for pictures to be included in all policy files due to the number of risks that are currently being inspected every year (stated in the previous paragraph). Maintaining photographs of insured property will assist management's evaluation of the condition and value of each property, and in the event of a claim. It is recommended that the company require submission of photographs with all applications and on inspected risks.

At its December 21, 2001 meeting, the board implemented a \$25 policy fee, and raised Homeowner rates by 15%. On March 21, 2000 the board compared its Homeowner rates with 8 other domestic companies. However these were the only discussions of rates that examiners noted. The company does not have a process to regularly review the adequacy of its rates (based on loss ratio) on each line of business, and to compare its rates with its competitors. It is suggested that the company develop a process to periodically review its loss ratio and rate adequacy on each line of business, and to compare its rates with its competitors.

## **Agents**

The company is required to file with this office all agents that write business for the company, pursuant to s. 628.11, Wis. Stat. The examination found that five agents on the company's list of active agents were not on the company's Registered Agent List maintained by this office, and forty-six agents reported on the Registered Agent List provided by this office were not included on the company's list of active agents. It is recommended that the company submit an application to the Office of the Commissioner of Insurance for all the company's agent appointments in accordance with s. 628.11, Wis.



Stats, and that the company notify the Office of the Commissioner of Insurance of all agents that are terminated or are no longer writing business.

The company's agent contract requires its agents to obtain their own adequate errors & omissions insurance coverage. However, the company does not require its agents to submit documentation of their E&O coverage to the office. It is recommended that the company obtain and retain a copy of all their agents' current Errors & Omissions coverage annually to make sure their agents have adequate E&O coverage in compliance with their agent contract.

### **Claims Adjusting**

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust and supervise the adjustment of losses. The company has Co CEO Steven Leadholm adjust claims as part of his duties. He is allowed to adjust and pay claims up to \$15,000. Any claim over that amount is reviewed by the board of directors and adjusting committee for approval to pay.

### **Accounts and Records**

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2001.

In reviewing cash controls the company has over the receipt and disbursement of cash, it was noted that the company did not have a written check signing policy. Company managers can write checks up to \$30,000 without two signatures. This appears to be too high. The company has sufficient staff to initiate a policy of two signatures for a lower check amount. It is recommended that the company

develop a written check signing policy that sets a limit for a single signature, and that the company require two signatures for all checks exceeding that amount.

A review of the company's Annual Statement Schedules was performed. It was noted that premium in-force equaled premium written on schedules H and H-1 in the annual statement. Although this is possible, it is not probable unless there were no policy cancellations or endorsements during the year. The examination noted policies did have endorsements and that there were cancellations during the year, therefore gross premium in-force should not equal gross premium written. It is recommended that the company accurately calculate and report gross premium in-force and gross premium written on schedule H and H-1 of the Annual Statement, respectively in accordance with the Town Mutual Annual Statement Instructions.

The company is audited annually by an outside public accounting firm.

#### **EDP Environment**

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computers is not limited to people authorized to use the computers. All employees have access to all computer files. It is recommended that the company establish procedures to limit access to its computers.

Company personnel back up the computers daily. The backed-up data is then taken and secured off-site. This process is completed everyday excluding weekends.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

#### **Disaster Recovery Plan**

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has not developed a disaster recovery plan. Therefore, It is recommended that the company develop a disaster recovery plan.

#### **Invested Assets**

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

### **Investment Rule Compliance**

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$964,844
2. Liabilities plus 33% of gross premiums written	1,037,876
3. Liabilities plus 50% of net premiums written	1,063,484
4. Amount required (greater of 1, 2, or 3)	1,063,484
5. Amount of Type 1 investments as of 12/31/2001	<u>190,354</u>
6. Excess or (deficiency)	<u>(873,130)</u>

The company does not have sufficient Type 1 investments.

The company had the following investment exceptions granted:

In 1997 the company was approved to hold their real estate property and two issues of stock that they owned prior to year-end 1996.

## **ASSETS**

### **Cash and Invested Cash**

**\$194,162**

The above asset is comprised of the following types of cash items:

Cash in company's office	\$ 100
Cash deposited in banks-checking accounts	3,708
Cash deposited in banks at interest	<u>190,354</u>
Total	<u><u>\$194,162</u></u>

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in one bank. Verification of checking account balances was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of three deposits in three depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2001 totaled \$18,270 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 3.95% to 6.30%. Accrued interest on cash deposits totaled \$3,085 at year-end.

### **Stocks and Mutual Fund Investments**

**\$466,680**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2001. Stocks owned by the company are located in a safety deposit box in their bank.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds were in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

There were no dividends declared or received during 2001 from stocks held by the company.

**Book Value of Real Estate****\$16,601**

The above amount represents the company's investment in real estate as of December 31, 2001. The company's real estate holdings consisted of the company's home office building. Subsequent to year-end the company sold their home office building. Details of the sale were discussed in the "Growth of the Company" section of this report.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method for the building and various appropriate accelerated depreciation methods for capitalized improvements.

**Agents' Balances and Premiums in the Course of Collection****\$78,385**

The above ledger asset is supposed to represent the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end.

An extensive review of the company's premium process revealed that the company bills four of its agencies for policies that are renewing in the next month. The company then records an asset for the entire advance agency billed amount (\$20,441 at year-end 2001) as Agents' Balances and Premiums in the Course of Collection and records a liability for Advance Premium for the same amount. However, statutory accounting does not allow recording premiums and agents' balances in the course of collection until the effective date of the policy has been reached, and does not allow a company to report advance premium until the premium is received. An adjustment of \$20,441 was made to decrease the above balance to eliminate the improper recording of advance agency billed premiums. It is recommended that the company properly record premiums and agents' balances in the course of collection in accordance with the Town Mutual Annual Statement Instructions. Further comments and recommendations will be made in a subsequent section labeled "Advance Premiums."

Since the company does not receive a detailed report from their agency billed agencies noting policy premiums that are overdue, the company is not capable of developing an accounts receivable aging report that includes policies that are agency billed. Therefore, it is recommended that

the company implement a policy that will provide them with the information to develop an accounts receivable aging report of policyholders that are agency billed.

**Deferred Premiums** **\$103,457**

The above ledger asset represent the amounts due from agents or policyholders at year-end on a deferred basis. The balance was verified by recalculating a sample taken from the company's deferred premium report testing for its accuracy.

**Investment Income Due and Accrued** **\$3,085**

Interest due and accrued on the various assets of the company at December 31, 2001, consists of the following:

<b>Asset</b>	<b>Interest Accrued</b>
Cash Deposits	\$3,085

The above balance was verified by recalculating it using outside source documentation. The examiner noted that interest rates for the CD's were incorrectly reported on the annual statement, and the maturity date on one of the cash deposits was incorrectly stated. The interest due and accrued was recalculated for year-end 2001 using the correct information and noted an immaterial difference. It is recommended that the company complete schedule B in the annual statement correctly and accurately in accordance with the Town Mutual Annual Statement Instructions.

**Reinsurance Recoverable on Paid Losses** **\$20,813**

The above asset represents recoveries due to the company from reinsurance on losses that were paid on or prior to December 31, 2001. A review of year-end accountings with the reinsurer verified the above asset.

**Electronic Data Processing Equipment** **\$14,239**

This asset represents the depreciated value of electronic data processing equipment purchased in 1994 through 2001. The company properly expensed non-operating software. The most recent purchases were traced to invoices and the company's cash disbursement records.

## LIABILITIES AND SURPLUS

### Net Unpaid Losses

**\$47,080**

This liability represents losses incurred on or prior to December 31, 2001, and remaining unpaid as of that date. The examiners did not find it necessary to develop the company's unpaid losses at year-end due to the fact that they reached their reinsurance contract's stop-loss attachment point. The balance appeared sufficient and no further development was deemed necessary.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

The examiners reviewed claim files for adequate information, which includes proof of loss statements, file documentation, accuracy of loss register, and pictures of the claim. It was noted that 94% of the claims files that were reviewed did not contain a signed proof of loss. It is the company's policy to have claimants' sign a proof of loss statement if their claim is over \$10,000 or the claim is related to a suspicious theft or fire claim. The amount set by the board requiring a proof of loss statement to be appears to be high; most town mutual insurers require signed proofs of loss for claims in the \$2,000 to \$4,000 range. Therefore, it is suggested that the company require that a proof of loss statement be completed for all claims exceeding a reasonable amount established by the board.

### Unpaid Loss Adjustment Expenses

**\$6,475**

The original liability of \$1,630 represents the company's estimate of amounts necessary to settle losses, which were incurred prior to December 31, 2001, but which remained unpaid as of year-end. The examiners tested the adequacy of the balance by calculating a Paid LAE to Paid Loss ratio and applying it to the unpaid loss balance, which resulted in an unpaid LAE balance of \$6,475. The company established this liability by multiplying the company's unpaid property losses for year-end by 5%. The percentage used to calculate the Unpaid LAE balance was increased from 3% because the company has incurred more losses the last few years. However, this method is not adequate compared to the Paid

LAE to Paid Loss method, which assumes that the ratio of paid LAE to paid losses should be similar to the ratio of unpaid LAE to unpaid losses. Therefore, it is suggested that the company use a different methodology to better estimate the year-end balance.

**Unearned Premiums** **\$475,981**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

**Reinsurance Payable** **\$23,676**

This liability consists of amounts due to the company's reinsurer at December 31, 2001, relating to transactions, which occurred on or prior to that date. Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

**Fire Department Dues Payable** **\$9,221**

This liability represents the fire department dues payable at December 31, 2001. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

**Borrowed Money Unpaid** **\$50,000**

This liability represents a note payable to a local bank at December 31, 2001 for a loan to the company that was secured by their real estate holding. Supporting record and subsequent cash disbursements verified this item. Interest payments were also reviewed and the examiners recalculated the year-end accrual for the interest. The company did not include an accrued interest payable on the note at December 31, 2001 in the annual statement. The accrued interest payable balance is immaterial, however it should be reported. It is recommended that the company accrues and reports interest due on borrowed money in accordance with the Town Mutual Annual Statement Instructions.

**Commissions Payable** **\$27,158**

This liability represents commissions earned by the company's agents but are unpaid at December 31, 2001. The balance was verified by tracing the company's detail to subsequent payments.

**Amounts Withheld for the Account of Others** **\$1,357**

This liability represents employee payroll deductions in the possession of the company at December 31, 2001. Supporting records and subsequent cash disbursements verified this item.



**Accounts Payable****\$6,828**

This liability represents amounts for expenses incurred in 2001 but not paid as of year-end. The company reported a year-end accounts payable balance of \$3,500. A search for unrecorded liabilities was performed to verify the accounts payable balance, and found eleven invoices that equaled \$6,828 that were due for 2001 expenses. This is a difference of \$3,328. An adjustment of \$3,328 was made to increase the accounts payable balance so it properly reflects year-end expenses due. It is recommended that the company properly accrues all expenses incurred in 2001 but not paid as of year-end in accordance to the Town Mutual Annual Statement Instructions.

**Accrued Property Taxes****\$4,800**

This liability represents the amount of 2001 property taxes that are unpaid at December 31, 2001. The balance includes taxes on both real property and personal property. The accrued amount was traced to 2001 property tax documents and a subsequent payment to verify the balance.

**Premiums Paid in Advance****\$20,441**

This liability is supposed to represent premiums paid on or before December 31, 2001 for the amount due on the next policy anniversary date.

As noted in the section of the report titled "Premiums and Agents' Balances in the Course of Collection" the company recorded an asset for the entire advance agency billed amount of \$20,441, and created a liability for advance premium for the same amount, when the bill is sent to the agencies. However, statutory accounting does not allow reporting advance premium until the premium is received. An adjustment was made to decrease the premiums paid in advance balance by \$20,441. It is recommended that the company only include payments received in advance for policies that become effective after year-end in the line item Premiums Paid in Advance per the Town Mutual Annual Statement Instructions.

## **V. CONCLUSION**

The examination of the Middleton Insurance Company resulted in 23 recommendations, 1 of these repeated from the prior examination, 3 suggestions, 2 adjustments, and 2 reclassifications. The adjustments resulted in an aggregate decrease to surplus of \$8,173. Many of the recommendations that were made related to the company's accounting practices and their reporting of balances on the various schedules in their annual statement.

The company has consistently incurred underwriting losses. The eight-year period under examination the company reported total underwriting losses of \$939,066. Recommendations and suggestions were made concerning documentation of risks, adhering to underwriting guidelines, devoting more resources towards inspections, and rates.

Another significant portion of the recommendations is related to the board's management and control of the company. Surplus has declined by 58% since the last examination and was close to the regulatory minimum surplus level at year-end 2001. The board has received suggestions from their auditors their CEO, a representative from their reinsurer, and their consulting accountant about improvements to its operations. However, the board has inadequately supervised management and has not taken timely actions for improvement.

The company has not had a full-time full-charge CEO since March 2001. The company could not provide job descriptions, responsibilities, evaluations, etc., for its two co-CEO positions. The company is in a weak financial position, however the board has not clearly delegated the responsibility for turning around the company's operations.

Because the company's surplus has decreased, the company must plan to make significant reductions in the number of agents and agencies it uses, and must plan to reduce its premium volume proportional to the loss in surplus. This report recommends that the company reduce its direct premium volume to less than 200% of its surplus by December 31, 2003.

Currently the company's management seems to be implementing the necessary procedures to correct immediate problems the company is facing, however they should have been implemented a lot sooner.

## VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 17 - Corporate Records—It is again recommended that minutes for all committees of the board of directors and that the board minutes indicate approval of investment transactions in accordance with s.181.1601, Wis. Stats.
2. Page 17 - Corporate Records—It is also recommended that the person(s) who maintains the board minutes and board appointed committee minutes also signs the copy of the typed meeting minutes. It is further recommended that the company maintain all reports and documents discussed at the meeting with the company's board minutes and board appointed committee minutes, in accordance with s. 181.1601(5)(d), Wis. Stats.
3. Page 18 - Management and Control—It is recommended that the company establish a complete detailed job description for each co-CEO position.
4. Page 19 - Conflict of Interest—It is recommended that the company have its directors complete conflict of interest questionnaires on an annual basis.
5. Page 19 - Conflict of Interest—It is recommended that the company amend its conflict of interest questionnaires to include language that addresses the question whether the director works as an agent for the company, and whether the director writes business for a direct competing insurance company.
6. Page 19 - Operating Results—It is recommended that the company file an updated long range planning report with the Office of the Commissioner of Insurance that addresses long and short term goals, financial projections, strategies, rate projections, loss control, inspections, and changes the company plans to implement.
7. Page 22 - Underwriting—It is recommended that the company devote more resources towards inspections to inspect all their policies within two years.
8. Page 22 - Underwriting—It is recommended that the company require submission of photographs with all applications and on inspected risks.
9. Page 22 - Underwriting—It is suggested that the company develop a process to periodically review its loss ratio and rate adequacy on each line of business, and to compare its rates with its competitors.
10. Page 22 - Agents—It is recommended that the company submit an application with the Office of the Commissioner of Insurance for all the company's agent appointments in accordance with s. 628.11, Wis. Stats, and that the company notify the Office of the Commissioner of Insurance of all agents that are terminated or are no longer writing business.
11. Page 23 - Agents—It is recommended that the company obtain and retain a copy of all their agents' current Errors & Omissions coverage annually to make sure their agents have adequate E&O coverage in compliance with their agent contracts.
12. Page 23 - Accounts and Records—It is recommended that the company develop a written check signing policy that sets a limit for a single signature, and that the company require two signatures for all checks exceeding that amount.
13. Page 24 - Accounts and Records—It is recommended that the company accurately calculate and report gross premium in-force and gross premium written on schedule H and H-1 of the annual statement, respectively in accordance with the Town Mutual Annual Statement Instructions.

14. Page 24 - EDP Environment—It is recommended that the company establish procedures to limit access to its computers.
15. Page 24 - Disaster Recovery Plan—It is recommended that the company develop a disaster recovery plan.
16. Page 27 - Agents' Balances and Premiums in the Course of Collection—It is recommended that the company properly record premiums and agents' balances in the course of collection in accordance to the Town Mutual Annual Statement Instructions.
17. Page 27 - Agents' Balances and Premiums in the Course of Collection—It is recommended that the company implement a policy that will provide them with the information to develop an accounts receivable aging report of policyholders that are agency billed.
18. Page 28 - Investment Income Due and Accrued—It is recommended that the company complete schedule B in the annual statement correctly and accurately in accordance with the Town Mutual Annual Statement Instructions.
19. Page 29 - Net Unpaid Losses—It is suggested that the company require that a proof of loss statement be completed for all claims exceeding a reasonable amount established by the board.
20. Page 30 - Unpaid Loss Adjustment Expenses—It is suggested that the company use a different methodology to better estimate the year-end balance.
21. Page 30 - Borrowed Money Unpaid—It is recommended that the company accrues and reports interest due on borrowed money in accordance with the Town Mutual Annual Statement Instructions.
22. Page 31 - Accounts Payable—It is recommended that the company properly accrue all expenses incurred in 2001 but not paid as of year-end in accordance to the Town Mutual Annual Statement Instructions.
23. Page 31 - Premiums Paid in Advance—It is recommended that the company only include payments received in advance for policies that become effective after year-end in the line item Premiums Paid in Advance per the Town Mutual Annual Statement Instructions.

## **VII. ACKNOWLEDGMENT**

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Ryan Hanson of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

John Litweiler  
Examiner-in-Charge

## **VIII. APPENDIX – SUBSEQUENT EVENTS**

As stated earlier, in the Management and Control section, since the former CEO resigned in March 2001, the company had employed two interim co-CEOs, but it was unclear what duties were assigned to whom and which one actually manages and makes decisions on behalf of the company. Subsequent to examination fieldwork, in 2003, the Company was able to provide this Office with documentation stating they currently have only one manager. It also clearly defined the responsibilities of the manager position.